

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 IO-13 NEA-10 SP-02 USIA-06 AID-05

EB-07 NSC-05 CIEP-01 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

LAB-04 SIL-01 L-03 H-02 PRS-01 PA-01 /105 W

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R 210136Z MAY 76

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 5224

INFO AMEMBASSY JAKARTA

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USADB

FOR NAC AGENCIES

E.O. 11652: ADS, DECLAS 11/21/76

TAGS: EAID, EFIN

SUBJECT: PROPOSED CONVERSION INTO EQUITY OF PREVIOUS ADB LOANS
TO INDONESIAN ELECTRIC UTILITY (PLN)

REF: A) MANILA 4240 B) TREASURY 75-181

SUMMARY: ADB MANAGEMENT PROPOSES ON NO OBJECTION BASIS
TO CONVERT INTO EQUITY PROCEEDS OF SEVEN PREVIOUS ADB
LOANS TO INDONESIA WHICH HAD BEEN RELENT TO PLN. PURPOSE
IS TO STRENGTHEN PLN'S CAPITAL STRUCTURE, PROVIDE DEBT
SERVICE RELIEF AND ASSIST IN FINANCIAL RECOVERY PLAN,
CONFORM WITH POLICY FOLLOWED BY IBRD, OTHER MAJOR LENDER
TO PLN. PROPOSAL CONCERNS RELENDING ONLY, SINCE TERMS OF
ADB LOANS TO BORROWER (GOI) WOULD REMAIN UNCHANGED. IF
NO BOARD MEMBER OBJECTS OR REQUESTS DISCUSSION OF PROPOSAL
BY 25 MAY 1976, RECOMMENDATION WILL BE DEEMED TO HAVE
BEEN APPROVED. USADB DOES NOT INTEND TO OBJECT. END
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SUMMARY.

1. ADB DEC R 47-76 DESCRIBING PROPOSAL POUCHED ADDRESSEES MAY 13. IF NO OBJECTION OR REQUEST FOR DISCUSSION RECEIVED BY MAY 25, PROPOSAL WILL BE DEEMED APPROVED.

2. ADB MANAGEMENT PROPOSING THAT PROCEEDS OF FIRST SEVEN LOANS BY BANK TO GOVT OF INDONESIA WHICH WERE RELENT TO PLN, BE CONVERTED INTO PLN EQUITY. TOTAL AMOUNT INVOLVED IS \$30.1 MILLION, WHICH UNDER TERMS OF FIRST SEVEN LOANS, WAS AGREED TO BE RELENT BY GOI TO PLN WITH REPAYMENT PERIOD OF 15 YEARS, INCLUDING GRACE PERIOD OF 5 YEARS. LOANS WERE APPROVED DURING PERIOD FROM JULY 1971 UNTIL DECEMBER 1973.

3. APPRAISALS OF VARIOUS LOANS TO PLN, INCLUDING MOST RECENT LOAN APPROVED APRIL 1976 (MANINJAU HYDROPOWER PROJECT, REFTEL A REFERS), HAVE DESCRIBED PLN'S WEAK FINANCIAL CONDITION AND LACK OF EQUITY CAPITAL. UNDER PROVISIONS OF VARIOUS IBRD CREDITS, FINANCIAL ASSESSMENTS OF PLN WERE UNDERTAKEN, PARTICULARLY TO ANALYSE REASONS FOR PLN'S RECURRING OPERATING LOSSES. IBRD STUDIES INCLUDED PROVISION OF CONSULTANT TO REVIEW TARIFFS, FINANCIAL MANAGEMENT PRACTICES, ACCOUNTING, ETC.

4. OUTCOME OF IBRD STUDY WAS FORMULATION OF 6-YEAR FINANCIAL RECOVERY PLAN FOR PLN FOR WHICH COMPLIANCE WAS STIPULATED AS COVENANT FOR THIRD IDA CREDIT (WEST JAVA THERMAL PROJECT). TARGET OF PLAN WAS GENERATION OF SUFFICIENT REVENUES BY 1978/79 TO COVER ALL EXPENSES, TO BE ACCOMPLISHED BY IMPLEMENTING VARIOUS MEASURES INCLUDING EFFECTIVE COST CONTROLS, AND UNBURDENING PLN FROM CURRENT DEBT SERVICE CHARGES AND INTEREST PAYMENTS. GOVT AND IDA AGREED NOT ONLY THAT PROCEEDS OF THIRD IDA CREDIT AND CORRESPONDING LOCAL CURRENCY FUNDS WOULD BE MADE AVAILABLE TO PLN AS GOVT EQUITY CONTRIBUTION, BUT ALSO TO RESTRUCTURE PLN'S CAPITAL BASE BY CONVERTING ALL ITS PRIOR DEBT TO EQUITY. THIS WAS DONE FOR ALL PRIOR IDA LOANS.

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5. PLN NOW MAKING SATISFACTORY PROGRESS IN ITS FINANCIAL RECOVERY HAS ATTAINED INTERIM TARGETS,E,G. COST/REVENUE RATIO HAS IMPROVED FROM 129 PERCENT IN FY 1973 TO 103 PERCENT FOR TY 75 (WHICH ENDED 31 MARCH 1975). IN ADDITION TO HIGHER TARIFFS, BETTER COLLECTIONS AND COST REDUCTION, COVERSION OF IBRD DEBT TO EQUITY WAS MAJOR FACTOR IN FINANCIAL IMPROVEMENT.

6. GOI, IBRD AND ADB AGREE ON DESIRABILITY THAT UNIFORM POLICY BE FOLLOWED BY PLN WITH RESPECT TO ALL DONOR FUNDS PROVIDED PRIOR TO MID-1975. IN VIEW OF FINANCIAL IMPROVEMENTS, AND PROVIDING PLN DOES NOT INCUR ANY NEW DEBT SERVICE CHARGES PRIOR TO END OF 1978/79, PLN DEEMED CAPABLE OF ASSUMING THESE CHARGES IN FUTURE (PROCEEDS OF RECENTLY APPROVED IBRD LOAN OF \$41 MILLION FOR 4TH POWER PROJECT, AND LAST TWO ADB LOANS, GARUNG HYDRO (NOV 1975 -\$19.8 MILLION) BEING RELENT TO PLN AND NOT PROVIDED AS EQUITY.)

7. GIVEN TOTAL SCALE OF PLN FINANCIAL STRUCTURE, FAILURE TO CONVERT ADB'S LOANS TO EQUITY AS PROPOSED BY MANAGEMENT, WOULD NOT HAVE SERIOUSLY ADVERSE FINANCIAL IMPACT. AGGREGATE INTEREST CHARGES ON 7 LOANS IS ABOUT RUPAC (RP.) 2.4 BILLION (\$5.8 MILLION EQUIV) ANNUALLY. PLN'S CURRENT EQUITY AND CAPITAL RESOURCES TOTAL ABOUT RP 334 BILLION (\$805 MILLION EQUIV) SO CAPITAL STRUCTURE WOULD NOT BE MATERIALLY AFFECTED IF ADB LOANS NOT TREATED AS EQUITY. HOWEVER, GOVT, BANK AND IBRD PREFER THAT UNIFORM POLICY BE FOLLOWED BY ALL DONORS.

8. FYI: UNDERSTAND THAT ALTHOUGH USAID/JAKARTA HAS NOT YET RECEIVED FORMAL REQUEST FROM GOI TO CONVERT TO EQUITY PROCEEDS OF US BILATERAL LOANS TO PLN, INDICATIONS ARE THAT AID/W IS LIKELY TO GIVE SYMPATHETIC CONSIDERATION TO SUCH A REQUEST IF RECEIVED. END FYI.

9. GIVEN NECESSITY FOR PLN TO ESTABLISH ADEQUATE EQUITY BASE BY UNDERTAKING FINANCIAL RECOVERY PLAN FOR WHICH REDUCTION OF DEBT SERVICE BURDEN IS NECESSARY, DESIRABILITY FOR MAJOR DONORS TO FOLLOW UNIFORM POLICY, AND SINCE BANK'S QUOTE LENDING AND RELENDING POLICIES LIMITED OFFICIAL USE

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UNQUOTE (WORKING PAPER 1-73 DATED 29 JANUARY 1973 PG 25) PERMIT TREATMENT OF BANK LOANS AS GRANT OR EQUITY IF JUSTIFIED, MANAGEMENT RECOMMENDS APPROVAL OF SUCH CONVERSION ON NO OBJECTION BASIS, WITH BOARD APPROVAL TO BE ASSUMED IF NO OBJECTION IS HEARD BEFORE 25 MAY. PROPOSAL DOES NOT ALTER TERMS OF LOANS BETWEEN ADB AND BORROWER (GOI), ONLY BETWEEN GOI AND PLN. USADB DOES NOT INTEND TO OBJECT. SULLIVAN

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